IN THE

Supreme Court of the United States

OCTOBER TERM, 1945

No. 279- 280

ABRAHAM KIRSCHENBAUM,
Petitioner,
against
COMMISSIONER OF INTERNAL REVENUE,
Respondent.

HARRY BANNER,
Petitioner,
against
COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT, AND BRIEF IN SUPPORT THEREOF.

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THE SORG PRINTING CO., INC., NEW YORK, N. Y.

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PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

To the Honorable Chief Justice and Associate Justices of the Supreme Court of the United States:

Petitioners pray that a writ of certiorari issue to review two judgments entered by the Circuit Court of Appeals for the Second Circuit on April 8, 1946, affirming two orders of The Tax Court of the United States.

Opinion Below

The opinion of the Circuit Court of Appeals, filed on April 8, 1946, is reported at 155 F. (2d) 23 and is printed in the record at pages 213-218.

Basis of Jurisdiction

Jurisdiction is invoked under Section 240(a) of the Judicial Code as amended by the Act of February 13, 1925, 43 Stat. 938, 28 U.S.C., Section 347(a).

Questions Presented

Five questions are presented which, petitioners contend, call for determination by this Court:

1. Where shareholders of a corporation transfer to it a portion of their stockholdings in such corporation and receive from that corporation an amount of money, is the amount so received in whole or in part taxable to them as essentially equivalent to the distribution of a dividend under Section 115(g) of the Internal Revenue Code, or is it taxable under Section 117 of such Code to the extent that it exceeds the cost of such stock to the stockholders?

2. Does the term "redemption" used in Section 115(g) of the Internal Revenue Code cover the purchase by a corporation of shares of its stock to be held as treasury stock subject to resale?

3. Is the Circuit Court of Appeals precluded, under the *Dobson* rule, from reviewing the determination of The Tax Court of the United States that the term "redemption" used in Section 115 (g) of the Internal Revenue Code covers the purchase by a corporation of shares of its stock to be held as treasury stock subject to resale?

4. Does Section 115(g) ever apply to redemption of stock which was originally issued bona fide?

5. Are Sections 112(c)(2) and 115(g) of the Internal Revenue Code in pari materia so that the inability under the Dobson rule to review a determination of The Tax Court of the United States under Section 112(c)(2) precludes the review by the Circuit Court of Appeals of a determination of The Tax Court of the United States under Section 115(g) of the Internal Revenue Code?

Summary Statement

Petitioners, with one Joseph Berkman, in June, 1934, organized under the laws of the State of New York a corporation under the name of Pedigree Fabrics, Inc. (hereinafter called the "corporation"), to engage in the business of rayon converting. The initial capitalization was $30,000, towards which each of the three individuals contributed the sum of $10,000 by subscribing for 100 shares (R. 170)*. Contracts for the corporation's raw materials are placed long before goods are mounted on the looms, making it necessary that commitments exceed net worth four or five times (R. 55-56).

In the years 1935-1938 inclusive, the corporation needed cash, and the petitioners and Mr. Berkman allowed part of their salaries to accumulate to their credit and subscribed for additional stock with their accumulated credit. On May 31, 1938, petitioners and Mr. Berkman each owned 240 shares, making an aggregate of 720 shares issued and outstanding (R. 170; 92, 93 and 127).

On June 19, 1939, Mr. Berkman died, and his widow insisted upon the purchase for cash of his one-third stock interest (R. 170). Burlington Mills Corporation, a main source of supply of raw materials, to which the corporation at the time of Mr. Berkman's death owed approximately $225,000, of which $70,000 was past due (R. 64-66)

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* Page of the Record.

objected to the purchases and if the corporation purchased the stock would insist upon the immediate payment of all bills (R. 142). Therefore, petitioners personally borrowed $13,300 and on September 1, 1939, equally purchased from the estate of the decedent for the sum of $25,100 the 240 shares owned by the estate. This purchase followed unsuccessful attempts on the part of petitioners to cause other persons to purchase the estate's shares (R. 170).

On May 31, 1940, the corporation issued a stock dividend of 7 shares for each 18 held (R. 170), and petitioners, being then the sole stockholders, received an additional amount of 140 shares each (R. 170). This stock dividend resulted from a suggestion by the treasurer of Burlington Mills Corporation, who desired that a substantial part of the surplus be capitalized so as to give to Burlington Mills Corporation proper credit protection (R. 143). The amount transferred from surplus to capital by the stock dividend was $28,000 (R. 94, 81). No other stock dividend was ever declared (R. 82).

In December of 1941, the financial condition of the corporation had greatly improved, and Burlington Mills Corporation had no objection to the sale by petitioners to the corporation of the stock which they previously acquired from the estate of the deceased associate consisting of 240 shares which, with the stock dividend thereon of 93⅓ shares, made a total of 333⅓ shares (R. 142). The stock of the corporation had a book value in December, 1941, of approximately $300.00 per share (R. 77).

At a meeting on December 20, 1941, of the Board of Directors of the corporation, it was resolved that the stock be purchased at $300 per share, and be held by the corporation as treasury stock subject to resale (R. 140, 171).

Four days later, petitioners transferred to the corporation 333⅓ shares and each received $50,000 therefor (R. 78). The certificates transferred to the corporation were

the identical certificates originally purchased from the Berkman estate, and the certificates representing the stock dividends on these shares. Thereafter a new certificate was issued in the name of the corporation representing shares equal to those so acquired (R. 141). This last-named certificate is for 333⅓ shares and has since been held in the corporate treasury (R. 171), where it now remains unredeemed and uncancelled (R. 85). It carries the notation on its face that it is subject to a stockholders' agreement subsequently made and on file (R. 141). It has been and is the intention of the corporation to sell these treasury shares to certain key employees.

On November 30, 1941, the corporation had a surplus of $29,231.53 and "Net Profits for Period" of $163,975.54. On December 31, 1941, the surplus was $185,463.06 (R. 171).

On May 31, 1943, and in May, 1944, dividends were declared by the corporation (R. 108).

The Tax Court of the United States held that the transfer by each petitioner of 166⅔ shares of the capital stock of the corporation in consideration of a payment by the corporation of $50,000 was not a sale but was a redemption of the stock and was made at such time and in such manner as to make such alleged redemption essentially equivalent to the distribution of a taxable dividend within the meaning of Section 115(g) of the Internal Revenue Code (R. 170-173). The Circuit Court of Appeals affirmed the Tax Court.

Reasons for Granting the Petition

1. The decision of the Circuit Court of Appeals that the term "redemption" used in Section 115(g) of the Internal Revenue Code covers the purchase by a corporation of shares of its own stock to be held as treasury stock subject to resale is in direct conflict with the decisions of the 3rd Circuit in *Amelia H. Cohen Trust* v. *Comm.*,

121 F. (2d) 689 (1941); of the 4th Circuit in *Benj. R. Britt*, 114 F. (2d) 10; and of the 5th Circuit in *Walter C. Hill* v. *Comm.*, 126 F. (2d) 570 (1942).

2. The decision of The Tax Court of the United States, which was affirmed in this case, that the term "redemption" used in Section 115(g) of the Internal Revenue Code covers the purchase by a corporation of shares of its own stock to be held as treasury stock subject to resale is in direct conflict with its own decisions: *W. C. Robinson*, 42 B.T.A. 725 (1940); *William A. Smith*, 38 B.T.A. 317 (1938); *R. W. Creech*, 46 B.T.A. 93 (1942); *Harold F. Hadley*, 1 T. C. 496 (1943).

3. The Circuit Court of Appeals has misapplied the *Dobson* rule by holding that it is precluded under that rule from reviewing the determination of The Tax Court of the United States that the term "redemption" in Section 115(g) of the Internal Revenue Code covers the purchase by a corporation of shares of its own stock to be held as treasury stock subject to resale.

4. The decision of the Circuit Court of Appeals that Section 115(g) of the Internal Revenue Code applies to the redemption of shares of stock originally issued bona fide is in direct conflict with the decision of the 1st Circuit in *Commissioner* v. *Cordingly*, 78 F. (2d) 118 (1935); of the 5th Circuit in *Malone* v. *Commissioner*, 128 F. (2d) 967 (1942); and of the 7th Circuit in *Commissioner* v. *Brown*, 69 F. (2d) 602 (1934).

5. The Circuit Court of Appeals has decided that Section 115(g) of the Internal Revenue Code applies to the redemption of stock originally issued bona fide.

6. The Circuit Court of Appeals, notwithstanding that the sections are not in *pari materia*, decided that because this Court precluded a review of a determination of the

Tax Court under Section 112(c)(2) of the Revenue Act of 1936 (*Commissioner* v. *Estate of Bedford,* 325 U.S. 283), it was precluded from reviewing a decision of the Tax Court under Section 115(g) of the Internal Revenue Code.

Wherefore, it is respectfully submitted that this petition for writ of certiorari to review the judgments of the Circuit Court of Appeals for the Second Circuit should be granted.

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BRIEF IN SUPPORT OF PETITION FOR CERTIORARI

OPINION BELOW

The opinion below has been referred to in the petition for writ of certiorari under this same caption.

JURISDICTION

The statement as to jurisdiction has been set forth in the petition.

STATEMENT OF THE CASE

The facts have been stated in the Summary Statement contained in the petition.

SPECIFICATIONS OF ERROR

1. The Circuit Court of Appeals erred in holding that under the *Dobson* rule it was precluded from reviewing the determination of The Tax Court of the United States that the term "redemption" in Section 115(g) of the Internal Revenue Code covers the purchase by a corporation of shares of its own stock to be held as treasury stock subject to resale.

2. The Circuit Court of Appeals erred in holding that because this Court precluded a review of a decision of The Tax Court of the United States under Section 112(c) (2) of the Revenue Act of 1936 (*Commissioner* v. *Estate of Bedford,* 325 U.S. 283 (1945)), it was precluded from reviewing a determination of The Tax Court of the United States under Section 115(g) of the Internal Revenue Code.

3. The Circuit Court of Appeals erred in failing to hold that Section 115(g) of the Internal Revenue Code never applies to the redemption of stock originally issued bona fide.

ARGUMENT

I. The Circuit Court of Appeals erred in holding that under the Dobson rule it was precluded from reviewing the determination of The Tax Court of the United States that the term "redemption" in Section 115(g) of the Internal Revenue Code covers the purchase by a corporation of shares of its own stock to be held as treasury stock subject to resale.

There is no dispute of fact in these cases. The Tax Court found that on December 20, 1941 the board of direc-

tors of the subject corporation adopted a resolution to purchase from the stockholders a specific number of shares of the corporation at $300 per share and to hold the stock so purchased as treasury stock subject to resale. (R. 170, 171). The Tax Court further found that thereafter petitioners, the stockholders of such corporation, each transferred to the corporation a stated number of shares and received from the corporation the amount specified in the corporate resolution (R. 171). The Tax Court further found that since such acquisition by the corporation, the shares of stock have been held by such corporation as treasury shares (R. 171). Upon these findings of fact, the Tax Court then stated the conclusion that the payment by the corporation for the stock was a "redemption" (R. 171).

Petitioners submit that the conclusion as to redemption is a conclusion of law and that such conclusion of law is clearly erroneous.

The Circuit Court of Appeals held that

> "As a preliminary to deciding whether the shares were 'redeemed', we must decide, even though *Alpers v. Commissioner, supra,* (126 Fed. (2d) 58) be law, that the point is not too enmeshed with the facts to be considered; * * *. We hold that the question is not plainly enough wrong to allow us to displace the decision of the Tax Court."

What the Circuit Court is saying, both in substance and effect, is that as a matter of law treasury shares are neither cancelled nor redeemed and that Section 115(g) cannot apply to such shares. The Circuit Court then states that this principle of law is still in effect and that if the same facts as are involved in the instant cases were presented in a District Court proceeding, the Circuit Court

would reverse a decision by the District Court that the stock involved had been redeemed. As the Circuit Court puts it:

> "* * * we can see no reason why our rule in *Alpers* v. *Commissioner, supra* (126 Fed. (2d) 58), should not have the same authority as any other of our decisions, should the question arise in a District Court; for it has never been intimated that the decisions of the Tax Court have that finality as precedents which they have when under review. That there should be one answer when the taxpayer pays his assessment and sues to recover it, and another when he resists collection, may appear inconsistent; but if consistency is eventually to prevail, it has not done so yet."

If the Second Circuit is right as to its inability to review a question of law arising from the Tax Court, a situation is presented where repugnant principles of substantive law are derived from identical facts, depending upon the selection of the original tribunal within the same Circuit.

Similar situations could occur under this erroneous extension of the *Dobson* rule in the other circuits where the *Alpers* rule is followed, namely, the Third, Fourth, and Fifth Circuits.

II. The Circuit Court of Appeals erred in holding that because this Court precluded a review of a decision of The Tax Court of the United States under Section 112(c)(2) of the Revenue Act of 1936 (Commissioner v. Estate of Bedford, 325 U.S. 283 (1945)), it was precluded from reviewing a determination of The Tax Court of the United States under Section 115(g) of the Internal Revenue Code.

In substance, the Circuit Court of Appeals has held that since this Court refused to review a determination

under Section 112(c)(2) of the Revenue Act of 1936 by reason of the *Dobson* rule, a review of the determination of The Tax Court of the United States under Section 115(g) was likewise precluded. This extension of the *Dobson* rule is apparently based upon purported analogous language in Sections 112(c) (2) and 115(g). Petitioners submit that the sections are different in purpose, language and operation.

Section 112(c)(2) was designed to prevent the taxation at capital gain rates of that portion of "boot" received in a tax-free exchange in a reorganization which represents a distribution of corporate earnings and profits. Without Section 112(c)(2) gain on "boot" received in a tax-free exchange would be taxable as capital gain. The design of Section 115(g) is to prevent dividend distributions from being masked or cloaked as capital transactions arising from the redemption or cancellation of stock.

Under Section 112(c)(2) the sole inquiry is as to the "effect" of a distribution, i.e., whether the distribution withdraws earnings and profits of the reorganized corporation. Section 115(g) embraces *all* the relevant indicia of a dividend distribution, i.e., whether the cancellation or redemption of stock is made at such time and in such manner as to give it the essence of a dividend distribution. The essence of a dividend distribution involves far more than its effect upon the earnings and profits of a corporation.

Under Section 112(c)(2) any distribution of earnings and profits which does not exceed the distributee's ratable share of accumulated earnings and profits is taxed as a dividend only to the extent specified. The distributee may, however, receive a distribution of earnings and profits beyond such ratable share and such excess would not be treated as a dividend distribution but would be treated as a capital gain. Under Section 115(g) all of

the earnings and profits distributed via a disguised dividend are taxable as a dividend. This marks an essential difference between the two sections. A basic characteristic of a dividend distribution is that it represents a distribution of corporate earnings and profits in proportion to the taxpayer's stock interest. Under Section 112(c)(2) this essential might be entirely lacking.

To say that the reviewability of a determination under Section 112(c)(2) has any relevance to the reviewability of a determination under Section 115(g) is to establish a relationship between the two sections that is non-existent. The Circuit Court of Appeals was not bound to apply the Dobson rule under Section 115(g) simply because the Supreme Court in an entirely unrelated situation had applied it to another section of the Internal Revenue Code, and its application is error.

III. The Circuit Court of Appeals erred in failing to hold that Section 115(g) never applies to the redemption of stock originally issued bona fide.

The Second and various other Circuits have held over a long period of time that Section 115(g) was enacted to prevent the avoidance of taxation by taxing as a dividend a distribution of earnings made in the guise of a redemption or cancellation of stock and that, accordingly, where the redeemed stock was originally issued for a bona fide business purpose, its subsequent redemption or cancellation would not be the occasion for the application of Section 115(g). The Second Circuit in the instant case has abandoned its position because of its determination that this Court in the *Bedford* case has rejected the principle that Section 115(g) never applies in the case of the redemption of stock originally issued bona fide; in other words, that the *Bedford* case overrules *Patty* v. *Helvering*, 98 F. (2d) 717 (1938).

Petitioners submit for the reasons set forth in Point II hereof and for the following reasons, that the *Bedford*

decision does not overrule *Patty* v. *Helvering, supra,* and that the question of whether the redeemed or cancelled stock was originally issued bona fide is still controlling in the determination of the application of Section 115(g). The opinion of the Tax Court in *Bedford* went upon Section 112(c)(2) alone. It did not involve Section 115(g). The Second Circuit disposed of the case under Sections 115(c) and (i) of the Revenue Act of 1936, adverting to *Patty* and other decisions merely for the proposition that earnings once capitalized by the issuance of stock dividends become capital except in tax avoidance situations. The rule of the *Patty* case to the effect that Section 115(g) has no application where stock cancelled or redeemed was originally issued bona fide was not raised. This Court affirmed the order of the Tax Court under Section 112(c)(2). Neither the *Patty* case nor Section 115(g) was mentioned by this Court. Actually this Court took pains to differentiate between Sections 115 and 112 and denied the applicability of Section 115(i) to Section 112.

The principle of the *Patty* case that Section 115(g) does not apply to the redemption or cancellation of stock whose original issuance was bona fide would appear to be left untouched by the *Bedford* decision. Since the historical basis of Section 115(g) was to prevent the avoidance of tax in the case of the cancellation or redemption of stock issued merely to escape taxes, the rationale of the *Patty* case is still appropriate where the issuance of the redeemed or cancelled stock was for a business purpose.

The present holding of the Second Circuit in the instant case that Section 115(g) applies irrespective of whether the original issuance of the redeemed or cancelled stock was bona fide is in direct conflict with the following cases and Circuits: 1st Circuit in *Commissioner* v. *Cordingly,* 78 F. (2d) 118 (1935); 5th Circuit in *Malone* v. *Commissioner,* 128 F. (2d) 967 (1942); and 7th Circuit in *Commissioner* v. *Brown,* 69 F. (2d) 602 (1934).

CONCLUSION

It is, therefore, urged that the petition for writ of certiorari should be granted.

Respectfully submitted,

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APPENDIX

Section 112(c) of the Revenue Act of 1936, provides as follows:

(c) Gain from Exchanges Not Solely in Kind.

(1) If an exchange would be within the provisions of subsection (b) (1), (2), (3), or (5) of this section if it were not for the fact that the property received in exchange consists not only of property permitted by such paragraph to be received without the recognition of gain, but also of other property or money, then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property.

(2) If a distribution made in pursuance of a plan of reorganization is within the provisions of paragraph (1) of this subsection but has the effect of the distribution of a taxable dividend, then there shall be taxed as a dividend to each distributee such an amount of the gain recognized under paragraph (1) as is not in excess of his ratable share of the undistributed earnings and profits of the corporation accumulated after February 28, 1913. The remainder, if any, of the gain recognized under paragraph (1) shall be taxed as a gain from the exchange of property.

Sections 115 (c), (g) and (i) of the Internal Revenue Code as it existed in 1941 read as follows:

(c) *Distributions in Liquidation.* — Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock, and amounts distributed in partial liquidation of a corporation shall be treated as in part or full payment in exchange for the stock. The gain or loss to the distributee resulting from such exchange shall be deter-

mined under section III, but shall be recognized only to the extent provided in section 112. Despite the provisions of section 117, the gain so recognized shall be considered as a short-term capital gain, except in the case of amounts distributed in complete liquidation. For the purpose of the preceding sentence, "complete liquidation" includes any one of a series of distributions made by a corporation in complete cancellation or redemption of all of its stock in accordance with a bona fide plan of liquidation and under which the transfer of the property under the liquidation is to be completed within a time specified in the plan, not exceeding, from the close of the taxable year during which is made the first of the series of distributions under the plan, (1) three years, if the first of such series of distributions is made in a taxable year beginning after December 31, 1937, or (2) two years, if the first of such series of distributions was made in a taxable year beginning before January 1, 1938. In the case of amounts distributed (whether before January 1, 1939, or on or after such date) in partial liquidation (other than a distribution to which the provisions of subsection (h) of this section are applicable) the part of such distribution which is properly chargeable to capital account shall not be considered a distribution of earnings or profits. If any distribution in complete liquidation (including any one of a series of distributions made by the corporation in complete cancellation or redemption of all its stock) is made by a foreign corporation which with respect to any taxable year beginning on or before, and ending after, August 26, 1937, was a foreign personal holding company, and with respect to which a United States group (as defined in section 331 (a) (2)) existed after August 26, 1937, and before January 1, 1938, then despite the foregoing provisions of this subsection, the gain recognized resulting from such distribution shall be considered as a short-term capital gain—

(1) Unless such liquidation is completed before July 1, 1938; or

(2) Unless (if it is established to the satisfaction of the Commissioner by evidence submitted before July 1, 1938, that due to the laws of the foreign country in which such corporation is incorporated, or for other reason, it is or will be impossible to complete the liquidation of such company before such date) the liquidation is completed on or before such date as the Commissioner may find reasonable, but not later than December 31, 1938.

(g) *Redemption of Stock.*—If a corporation cancels or redeems its stock (whether or not such stock was issued as a stock dividend) at such time and in such manner as to make the distribution and cancellation or redemption in whole or in part essentially equivalent to the distribution of a taxable dividend, the amount so distributed in redemption or cancellation of the stock, to the extent that it represents a distribution of earnings or profits accumulated after February 28, 1913, shall be treated as a taxable dividend.

(i) *Definition of Partial Liquidation.*—As used in this section the term 'amounts distributed in partial liquidation' means a distribution by a corporation in complete cancellation or redemption of a part of its stock, or one of a series of distributions in complete cancellation or redemption of all or a portion of its stock.

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CITATIONS

In the Supreme Court of the United States

OCTOBER TERM, 1946

No. 279

ABRAHAM KIRSCHENBAUM, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

No. 280

HARRY BANNER, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Tax Court of the United States (R. 169–173) is a memorandum opinion and therefore not officially reported. The opinion of the Circuit Court of Appeals (R. 213–217) is reported at 155 F. 2d 23.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on April 8, 1946. (R. 217–218.) The petition for a writ of certiorari was filed on July 5, 1946. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Whether there was substantial evidence to support the decision of the Tax Court that a redemption of part of the corporation's stock was made at such time and in such manner as to make the distribution to the taxpayers essentially equivalent to the distribution of a taxable dividend within the meaning of Section 115 (g) of the Internal Revenue Code.

2. Whether, where a corporation purchased equal amounts of stock from its two stockholders and retained the shares as treasury stock under the circumstances of this case, the corporation had redeemed the stock within the meaning of Section 115 (g) of the Internal Revenue Code.

STATUTE AND REGULATIONS INVOLVED

Internal Revenue Code:

> SEC. 115. DISTRIBUTIONS BY CORPORATIONS.
>
> (a) *Definition of Dividend.*—The term "dividend" when used in this chapter (except in section 203 (a) (3) and section 207 (c) (1), relating to insurance companies) means any distribution made by a

corporation to its shareholders, whether in money or in other property, (1) out of its earnings or profits accumulated after February 28, 1913, or (2) out of the earnings or profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made.

(b) *Source of Distributions.*—For the purposes of this chapter every distribution is made out of earnings or profits to the extent thereof, and from the most recently accumulated earnings or profits. Any earnings or profits accumulated, or increase in value of property accrued, before March 1, 1913, may be distributed exempt from tax, after the earnings and profits accumulated after February 28, 1913, have been distributed, but any such tax-free distribution shall be applied against and reduce the adjusted basis of the stock provided in section 113.

(c) *Distributions in Liquidation.*—Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock, and amounts distributed in partial liquidation of a corporation shall be treated as in part or full payment in exchange for the stock. The gain or loss to the distributee resulting from such exchange shall be determined under section 111, but shall be recognized

only to the extent provided in section 112. Despite the provisions of section 117, the gain so recognized shall be considered as a short-term capital gain, except in the case of amounts distributed in complete liquidation. * * * In the case of amounts distributed (whether before January 1, 1939, or on or after such date) in partial liquidation (other than a distribution to which the provisions of subsection (h) of this section are applicable) the part of such distribution which is properly chargeable to capital account shall not be considered a distribution of earnings or profits. * * *

* * * * *

(g) *Redemption of Stock.*—If a corporation cancels or redeems its stock (whether or not such stock was issued as a stock dividend) at such time and in such manner as to make the distribution and cancellation or redemption in whole or in part essentially equivalent to the distribution of a taxable dividend, the amount so distributed in redemption or cancellation of the stock, to the extent that it represents a distribution of earnings or profits accumulated after February 28, 1913, shall be treated as a taxable dividend.

* * * * *

(i) *Definition of Partial Liquidation.*—As used in this section the term "amounts distributed in partial liquidation" means a distribution by a corporation in complete cancellation or redemption of a part of its stock, or one of a series of distributions in

complete cancellation or redemption of all or a portion of its stock.

* * * * *

(26 U. S. C. 115.)

Treasury Regulations 103, promulgated under the Internal Revenue Code:

> SEC. 19.115–9. *Distribution in redemption or cancellation of stock taxable as a dividend.*—* * *
>
> The question whether a distribution in connection with a cancellation or redemption of stock is essentially equivalent to the distribution of a taxable dividend depends upon the circumstances of each case. A cancellation or redemption by a corporation of a portion of its stock pro rata among all the shareholders will generally be considered as effecting a distribution essentially equivalent to a dividend distribution to the extent of the earnings and profits accumulated after February 28, 1913. On the other hand, a cancellation or redemption by a corporation of all of the stock of a particular shareholder, or that the shareholder ceases to be interested in the affairs of the corporation, does not effect a distribution of a taxable dividend. A bona fide distribution in complete cancellation or redemption of all of the stock of a corporation, or one of a series of bona fide distributions in complete cancellation or redemption of all of the stock of a corporation, is not essentially equivalent to the distribution of a taxable dividend. * * * in all other

cases the facts and circumstances should be reported to the Commissioner for his determination whether the distribution, or any part thereof, is essentially equivalent to the distribution of a taxable dividend.

STATEMENT

The facts as found by the Tax Court (R. 170–171) may be summarized as follows:

The two taxpayers owned all the stock of Pedigree Fabrics, Inc., a corporation. In December, 1941, when Pedigree had earnings and profits of about $185,000, it bought from each of the two taxpayers one-third of his stock for $50,000. (R. 171). Thereafter each taxpayer continued to own one-half of the outstanding stock of Pedigree and Pedigree retained the stock as treasury stock. The Tax Court found that the purchase of the stock by Pedigree had no business purpose and that the object of the transaction, as well as the effect, was the distribution of a taxable dividend within the meaning of Section 115 (g) of the Internal Revenue Code. The taxpayers appealed to the court below, which affirmed the decision of the Tax Court.

ARGUMENT

1. The application of Section 115 (g) of the Internal Revenue Code and the corresponding provision of earlier Revenue Acts has generally been considered a question depending upon the

particular circumstances of each case.[1] The Treasury Regulations, which have been in effect for a great many years, expressly state that the question "depends upon the circumstances of each case." See Treasury Regulations 103, Section 19.115–9, *supra.* Consequently, in every instance that a petition for a writ of certiorari has been sought in a case involving Section 115 (g), this Court has denied the writ. *Commissioner* v. *Babson,* 70 F. 2d 304 (C. C. A. 7), certiorari denied, 293 U. S. 571; *Hyman* v. *Helvering,* 71 F. 2d 342 (App. D. C.), certiorari denied, 293 U. S. 570; *Randolph* v. *Commissioner,* 76 F. 2d 472 (C. C. A. 8), certiorari denied, 296 U. S. 599; *McGuire* v. *Commissioner,* 84 F. 2d 431 (C. C. A. 7), certiorari denied, 299 U. S. 591; *Commissioner* v. *Brown,* 69 F. 2d 602 (C. C. A. 7), certiorari denied, 293 U. S. 570.

Since the question is one of fact, the only question before the court below was whether there

[1] *Commissioner* v. *Straub*, 76 F. 2d 388 (C. C. A. 3); *Commissioner* v. *Champion*, 78 F. 2d 513, 514 (C. C. A. 6); *Commissioner* v. *Cordingley*, 78 F. 2d 118, 120–121 (C. C. A. 1); *Brown* v. *Commissioner*, 79 F. 2d 73, 74 (C. C. A. 3); *Hill* v. *Commissioner*, 66 F. 2d 45 (C. C. A. 4); *Robinson* v. *Commissioner*, 69 F. 2d 972 (C. C. A. 5); *Commissioner* v. *Rockwood*, 82 F. 2d 359 (C. C. A. 7); *Hirsch* v. *Commissioner*, 124 F. 2d 24 (C. C. A. 9); *Flanagan* v. *Helvering*, 116 F. 2d 937 (App. D. C.); *Smith* v. *United States*, 121 F. 2d 692 (C. C. A. 3); *Vesper Co.* v. *Commissioner*, 131 F. 2d 200 (C. C. A. 8); *Bazley* v. *Commissioner*, 155 F. 2d 237 (C. C. A. 3), petition for a writ of certiorari pending, No. 287, this Term. See also cases cited in the text in which this Court denied certiorari.

was substantial evidence to support the decision of the Tax Court. The record shows that Pedigree acquired the same amount of stock from each of the two stockholders of the corporation and paid the same amount of money to each stockholder, namely, $50,000; that petitioners continued to own the same proportion of the stock of the corporation, namely, one-half, after the corporation bought the stock. Furthermore, the corporation's balance sheet as of November 30, 1941 (the date of the purchase was December 20, 1941), shows surplus and net profit of more than $193,000 (R. 136, 171) and the balance sheet as of December 31, 1941, shows a surplus of more than $185,000 (R. 138, 171); and the business of Pedigree seemed to be expanding rather than diminishing in 1941, as shown by the fact that the net sales for the year ending May 31, 1941, were about $2,800,000, and for the year ending May 31, 1942, they were about $6,590,000. The net income of the corporation increased from about $43,000 as of May 31, 1941, to about $580,000 as of May 31, 1942. (R. 155.) No cash dividends were declared prior to 1943. We think that these facts constitute substantial support for the decisions of the Tax Court and of the court below.

Moreover, the facts of the instant case are strikingly similar to the illustration in the Congressional Committee Reports, when the antecedent of Section 115 (g) (Section 201 (g) of the Revenue Act of 1926) was first put in the Revenue

Act. The example is as follows: Assume that two men hold all the stock of a corporation for which each had paid $50,000 in cash, and the corporation had accumulated a surplus of $50,000 above its cash capital; and the corporation buys from each stockholder for cash one-half of his stock. The Committee Reports show that Congress attempted to make it clear that such a transaction should be taxed as a dividend.[2]

The petitioners rely upon the rule laid down by the court below in *Patty* v. *Helvering,* 98 F. 2d 717, 719, to the effect that "if redeemed shares have been issued bona fide, Section 115 (g) never applies." The court below decided that its decision in the *Patty* case was overruled in effect by the decision of this Court in *Commissioner* v. *Estate of Bedford,* 325 U. S. 283, reversing a decision of the court below, while the taxpayer insists that it was not overruled. (Br. 15.)

In the *Bedford* case this Court had under consideration a statute similar to Section 115 (g), namely, Section 112 (c) (2), which provides that where a cash distribution in connection with a statutory reorganization *has the effect of the distribution of a taxable dividend,* there shall be taxed as a dividend to each distributee such an amount of the gain recognized under Section 112 (c) (1) as is not in excess of his ratable share

[2] H. Rep. 356, 69th Cong., 1st sess., p. 30. See also H. Rep. 1, 69th Cong., 1st sess., p. 5; S. Rep. 52, 69th Cong., 1st sess., p. 15.

of the undistributed earnings and profits of the corporation accumulated after February 28, 1913. The Tax Court held in the *Bedford* case that the cash distribution had the effect of the distribution of a taxable dividend within the meaning of Section 112 (c) (2); the court below reversed the Tax Court and held that the distribution was a partial liquidation within the meaning of Section 115 (i) and therefore came under the provisions of Section 112 (c) (1); this Court reversed the decision of the court below and upheld the decision of the Tax Court. Assuming that Section 112 (c) (2) and Section 115 (g) are substantially similar in regard to treating a distribution as the equivalent of a taxable dividend, although it is not in the form of a taxable dividend, and that the redeemed stock was issued bona fide in the *Bedford* case, there is no way of reconciling the result reached by this Court in the *Bedford* case with the rule of the court below in the *Patty* case, namely, if redeemed shares are issued bona fide, Section 115 (g) never applies. Therefore the effect of the decision of this Court in the *Bedford* case is to overrule the *Patty* case. Moreover, this Court indicated that it would apply the rule of *Dobson* v. *Commissioner,* 320 U. S. 489; if the case did not turn "on a generalizing principle." (325 U. S. at p. 292.) This holding would also seem to conflict with the view laid down by the court below in the *Patty* case that the application of Section 115 (g) rested upon a constitutive principle.

The petitioners argue that the decision of the court below is in direct conflict with *Commissioner* v. *Cordingley, supra; Malone* v. *Commissioner,* 128 F. 2d 967 (C. C. A. 5); and *Commissioner* v. *Brown, supra,* insofar as it holds that Section 115 (g) applies regardless of whether the original issuance of the stock redeemed was bona fide. (Br. 15.) We do not interpret the *Cordingley* or *Brown* cases or any other Circuit Court of Appeals decisions as having adopted the so-called constitutive principle laid down in the *Patty* case that Section 115 (g) never applies if the stock was issued bona fide. We think that the First and Seventh Circuits treated the question as one of fact. *Malone* v. *Commissioner, supra,* did not involve Section 115 (g).

2. This Court has said that the rule is well established that on questions of fact it accepts the findings in which two courts concur, unless clear error is shown. *Texas & N. O. R. Co.* v. *Railway Clerks,* 281 U. S. 548, 558. The petitioners contend that it was "clearly erroneous" for the Tax Court to decide that stock which was acquired by Pedigree and retained as treasury stock was redeemed within the meaning of Section 115 (g) of the Internal Revenue Code. The court below conceded that there was some authority to the effect that treasury shares were not redeemed, but held that the ruling "is not plainly enough wrong to allow us to displace the decision of the Tax Court." (R. 217.) See L. Hand, J., dissenting in

Alpers v. *Commissioner,* 126 F. 2d 58 (C. C. A. 2). We agree with the court below that the status of treasury shares is not made entirely clear in the books. Therefore, it could not reasonably be said that the holding of the Tax Court was clearly erroneous. Moreover, Section 115 (g) would be rendered totally ineffective if it did not apply where the corporation retained the stock as treasury stock.

The petitioners allege that the decision of the court below in this respect is in direct conflict with the decisions in *Amelia H. Cohen Trust* v. *Commissioner,* 121 F. 2d 689 (C. C. A. 3); *Britt* v. *Commissioner,* 114 F. 2d 10 (C. C. A. 4); and *Hill* v. *Commissioner,* 126 F. 2d 570 (C. C. A. 5).[3] (Pet. 5–6.) None of those cases involved the application of Section 115 (g); they dealt with the question whether an admitted gain on the sale of stock to a corporation was a capital gain

[3] Since 1942 this line of cases is not important because in that year Congress in Section 147 of the Revenue Act of 1942. c. 619, 56 Stat. 798, amended Section 115 (c) so that all gain derived from partial liquidation should be taxable at the capital gain rates. The reason given for such action as shown by the Congressional Committee Reports was that inequality resulted under the then existing law in the case of unquestionable bona fide redemptions of stock not equivalent in any way to the distribution of a taxable dividend and because it was believed that the proper application of Section 115 (g) would prove adequate to prevent taxable dividends disguised as liquidations from receiving capital gain treatment. S. Rep. 1631, 77th Cong., 2d sess., p. 116; H. Rep. 2333, 77th Cong., 2d sess., p. 93.

or ordinary gain, not whether the transaction was essentially equivalent to the distribution of a taxable dividend. It may be pointed out that the word "complete" precedes the words "cancellation or redemption" in Section 115 (i) but does not appear in Section 115 (g), and also that there are at least two court decisions in which Section 115 (g) was applied although the corporation held the reacquired stock as treasury stock. *Robinson* v. *Commissioner,* 69 F. 2d 972 (C. C. A. 5); *Fostoria Glass Co.* v. *Yoke,* 45 F. Supp. 962 (N. D. W. Va.). There are no cases as far as we can ascertain in which a court refused to apply Section 115 (g) because the reacquired stock was not immediately retired.

Assuming, however, that there was no redemption of stock within the meaning of Section 115 (g), we believe that the Tax Court and the court below reached the correct result, because the Tax Court found as a fact that no business purpose of the corporation was served by the transaction now in question. If that is so, we may disregard the transfer of stock certificates and treat the transaction as an outright distribution of a cash dividend within the meaning of Section 115 (a) and (b). See *Gregory* v. *Helvering,* 293 U. S. 465; *Commissioner* v. *Court Holding Co.,* 324 U. S. 331.

CONCLUSION

The decision of the court below is correct and there is no direct conflict of decisions. The con-

struction of Section 115 (g) upon which the petitioners rely was laid down in a decision of the court below which was in effect overruled by the decision of this Court in the *Bedford* case. The petition for a writ of certiorari should therefore be denied.

Respectfully submitted.

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